In the Supreme Court of the United States

OCTOBER TERM, 1968

No. 489

ARNOLD VAN DEN WYMELENBERG, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

This is a gift tax case arising from the transfer on July 6, 1961, of a parcel of real estate in trust for 12 minor children (R. 14–15).[1] The first issue is whether the settlor's 1963 amendments to the instrument could be given retroactive effect to meet the standards that Section 2503(c) of the Internal Revenue Code of 1954 establishes as requisites to the $3,000 per donee gift tax exclusion allowed by Section 2503(b). The second issue is whether the courts properly ruled that the income interests in the trust could not be valued with sufficient precision to allow, in the alternative, exclusions based

[1] "R." refers to the appendix to petitioner's brief in the court of appeals.

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on the 1961 value of the donees' income rights during minority.

Under the trust agreement, the corpus would neither pass to the estate nor be subject to a testamentary power of appointment of any beneficiary who died during minority. Therefore, under Section 2503(c) of the 1954 Code, the gifts of the corpus failed as a gift of a "present interest" that would be entitled to the exclusions.[2] In September 1963, the settlors attempted to amend the 1961 instrument *nunc pro tunc* so as to introduce provisions which would bring it into compliance with the requirements of Section 2503(c) (R. 15).

The Commissioner assessed deficiencies because of his view that the 1961 instrument failed as a gift of a present interest, and the 1963 amendments could not be relied on to change the tax consequences. He also rejected the alternative claim to exclusions premised on the income rights, basing his action on the ground that the trustees' powers to reinvest the corpus and to allocate expenses and distributive shares of the income between corpus and beneficiaries meant that the value of the income interests could not be ascertained. The trustee was given, for example, power (R. 9), limited only by his "good faith", "[t]o determine whether any money or other property coming into the hands of the Trustee is part of the principal of the trust fund or income therefrom, and to apportion be-

[2] The trust corpus did qualify for the lifetime exemption of $30,000 provided by Section 2521 of the Code, to the extent the donor had not consumed it by prior gifts.

tween principal and income, any loss of [sic] expenditures which, in Trustee's Opinion, should be apportioned". Thus, the trustee could, as he did here, exercise complete discretion in deciding the extent to which the rentals would be used to amortize the mortgage rather than produce current income for the beneficiaries.[2]

In the resulting suit for refund, the district court rejected the contention that the 1963 amendments retroactively cured the defect in the gift of the corpus. It also sustained the Commissioner's position that the value of the income interest was too indefinite to qualify for the exclusions. The court of appeals affirmed (R. 16–20; Pet. App. 11–16).

The decision below is correct. There is no conflict in decisions of the courts of appeals appropriate for resolution here, and there is no other ground for certiorari.

1. There is no dispute about the fact that the trust, as originally drafted and executed, failed to qualify as a gift of present interests in the corpus, and that the September 1963 amendments were essential to the claim of the tax benefit. The situation as it existed in 1961, however, must be the dispositive measure of the tax consequences, for the case falls within the familiar principle that taxes cannot be assessed on the basis of mere intentions to dispose of property.

[2] The record shows that in the first fiscal year of the trust's existence the trustees negotiated a new mortgage on the real estate that constituted the sole asset of the trust and applied $5,700 to payment of principal and interest. Of $10,000 gross rentals in that year, only $2,286.53 remained for distribution to the income beneficiaries (R. 4–5, 13).

E.g., United States v. *Culbertson*, 337 U.S. 733, 740; see, also, *Commissioner* v. *Gordon*, 391 U.S. 83, 96.

For example, several circuits have held that even a judicially directed *nunc pro tunc* reformation of a trust cannot have retroactive tax consequences, where a material change in the original trust terms is required to achieve the desired tax result. See, *e.g.*, *M. T. Straight's Trust* v. *Commissioner*, 245 F. 2d 327 (C.A. 8); *Sinopoulo* v. *Jones*, 154 F. 2d 648 (C.A. 10); see, also, *Van Vlaanderen* v. *Commissioner*, 175 F. 2d 389 (C.A. 3); *Daine* v. *Commissioner*, 168 F. 2d 449 (C.A. 2). The instant case, where there was only an amendment by the voluntary act of the settlors, is an *a fortiori* situation for the application of this rule.

We disagree with petitioner's assertion (Pet. 8) that the decision below conflicts with *Flitcroft* v. *Commissioner*, 328 F. 2d 449 (C.A. 9). In that case trusts which the taxpayers had established for their children failed to state expressly whether the grants were irrevocable. Thereafter it was brought to the attention of counsel that California law presumed revocability. A California *nisi prius* court was asked to, and did, reform the instrument (328 F. 2d at 452) "'in accordance with the express intent of the trustors and trustee'" by expressly providing that the trusts "'were irrevocable from the date of their execution'". Finding that the State proceeding was non-collusive, the Ninth Circuit gave conclusive effect to the State court's decision (*id.* at 459).

It is clear, however, that the Ninth Circuit would not adopt a similar analysis in the present case, for

the absence of a court decree of reformation constitutes an essential distinction. Indeed, it was on this ground that the Ninth Circuit in *Flitcroft* distinguished its earlier decision in *Gaylord* v. *Commissioner*, 153 F. 2d 408, which had refused to allow a retroactive amendment by the settlors to determine the tax consequences. See 328 F. 2d at 457.

Perhaps *Flitcroft* conflicts with *M. T. Straight's Trust, supra*, and the other cases cited above and by the Seventh Circuit in this case. Even that is not clear, since those cases, unlike *Flitcroft*, involved retroactive reformations that added provisions which were contrary to or at least could not have been read into the explicit terms of the original instrument. But even if there is such a conflict, the absence of a court ordered reformation would make the present case an improper vehicle for resolving it. Moreover, any such conflict would no longer be of consequence, in view of this Court's intervening decision in *Commissioner* v. *Estate of Bosch*, 387 U.S. 456, 457, that federal authorities are not bound by a characterization of property interests rendered by a State trial court, a circumstance which means that the Ninth Circuit could not today follow *Flitcroft* in a case involving a judicially directed reformation.

2. The courts below correctly decided that the value of the income interest in the trust could not be determined with sufficient precision to allow the settlors to claim exclusions based on the 1961 value of the income right given each minor. To qualify for the gift tax exclusion a gift must be both a gift of a present

interest[4] and have a value that may be ascertained at the time of the gift. The powers given here allowed the trustee to vary in any manner the amount of income received by the beneficiaries in any year; indeed nothing in the instrument compelled the payment of any income to the beneficiaries. Numerous decisions recognize that, in such circumstances, the value of the income interest is too uncertain to qualify for the exclusion.[5]

This result does not conflict (see Pet. 9–10) with *Rosen* v. *Commissioner*, 397 F. 2d 245 (C.A. 4). The decision in *Rosen* did not hinge on the powers of the trustees, but focused on the nature of the corpus, which consisted of shares of a family controlled corporation which had never paid a dividend, and which might never do so. The Tax Court held that the present value of the income interest could not be valued. On appeal the Fourt Circuit reversed, and held that the actuarial tables of Treasury Regulations, Sec. 25.2512-5(f), should be used to fix the value because the stock could be traded.

In our view the result in *Rosen* is wrong, because the record there plainly showed that the stock in question was unlikely to pay dividends or be sold. Nevertheless, the decision goes only to the question whether the value of an income interest in a particular type of security may be the subject of a present esti-

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[4] See, *e.g.*, *Commissioner* v. *Disston*, 325 U.S. 442; *Fondren* v. *Commissioner*, 324 U.S. 18; *United States* v. *Pelzer*, 312 U.S. 399.

[5] See, *e.g.*, *Fischer* v. *Commissioner*, 288 F. 2d 574, 577 (C.A. 3); *Funkhouser's Trusts* v. *Commissioner*, 275 F. 2d 245, 247 (C.A. 4); *Commissioner* v. *Brandegee*, 123 F. 2d 58, 61 (C.A. 1).

mate. Here it is clear that the original trust assets would generate income. As *Rosen* expressly recognizes, 397 F. 2d at 247–248, there is an entirely distinct problem where, as here, trustees have extensive powers to allocate that income.* The tables used in *Rosen* could not provide a fair prediction of the way in which the trustee would exercise the discretion he has here; those tables at best may be used where all income must be paid to the beneficiaries and the problem is to make an estimate of the income that the corpus will produce. Cf. *Weller* v. *Commissioner*, 38 T.C. 790.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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* Although the trustee here, like those in *Rosen*, had broad powers to reinvest, the income interests in the present trusts failed to have an ascertainable value simply by reason of the trustee's power of allocation. The government did not contend in *Rosen*, as it does here, that the power to reinvest also placed the gift beyond valuation.

U.S. GOVERNMENT PRINTING OFFICE, 1968